



December 20, 2011

VIA ELECTRONIC AND CERTIFIED MAIL

Thomas E. Hintermister
Acting Assistant Staff Director
Audit Division
Federal Election Commission
999 E Street, NW
Washington, DC 20463

Re: Preliminary Audit Report Response of the McCain Presidential Committees

Dear Mr. Hintermister:

McCain-Palin 2008, Inc. and McCain-Palin Compliance Fund, Inc. have endeavored to comply strictly with Commission rules. They believe that their success in doing so is demonstrated by the fact that the Audit Division's three-year audit of McCain-Palin 2008, McCain-Palin Compliance Fund, and their seven affiliated joint fundraising committees has identified only two outstanding issues: (1) press reimbursement calculation methods that the Audit Division concedes did not result in "the General Committee ... receiv[ing] travel reimbursements from the Press that exceeded the maximum allowed by the regulations";¹ and (2) certain 48-Hour Notices that were not filed due to an outside vendor's data-management error and concerned contributions only used for compliance purposes.

McCain-Palin 2008 and McCain-Palin Compliance Fund discuss each of these issues, which were identified in the Commission's Preliminary Audit Report ("PAR"), in the paragraphs below.

I. PRESS REIMBURSEMENT CALCULATION METHODS

The Press covering Senator John McCain's participation in the 2008 presidential campaign travelled predominantly on an aircraft chartered by the McCain Campaign through a contract with Swift Air, LLC. John McCain 2008 (the "Primary Committee") and McCain-Palin 2008 (the "General Committee") agreed to pay Swift Air \$6,384,000 in exchange for 425.6 total

¹ Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

flight hours from June 30th to November 15th.² The total fee paid by the Primary Committee and the General Committee was fixed, in that \$6,384,000 was still due even if fewer than 425.6 hours were ultimately flown.³ This is relevant because the two Committees, in fact, only used 252.1 of the 425.6 contracted flight hours (111.8 hours were used by the Primary Committee, 140.3 hours by the General Committee).

The Primary Committee and the General Committee were legally authorized to seek reimbursement from travelling Press entities for a pro rata share of the \$6,384,000 fixed-payment total and other travel expenses.⁴ The Audit Division does not allege that any ineligible expenses were billed to the Press for reimbursement.⁵ And significantly, the Audit Division concedes that the Primary Committee and the General Committee collected the proper total from the Press:

The Audit staff agrees that when using the *total* Swift Air LLC contract amount for both the primary and general election periods ... the General Committee did not receive travel reimbursement from the Press that exceeded the maximum allowed by the regulations.⁶

Press “overhilling” is therefore not an issue in the PAR. The total amount billed and received by the Primary Committee and the General Committee was, by the Audit Division’s statement, a legally proper amount.

Instead, the Audit Division argues that the two Committees should have better “match[ed] the cost of the campaign to the proper election.”⁷ Put differently, the Audit Division thinks that, although the two Committees together collected the proper total from the Press, the General Committee received too much of the total and the Primary Committee received too little.⁸

The General Committee, which is named in the PAR, does not dispute that Press reimbursements could be rebalanced between the two Committees, now with the benefit of hindsight. The General Committee, however, argues that: (A) the Primary Committee and the

² The contract permitted a maximum number of 22.4 flight hours flown in a week. If the maximum weekly hours were not flown, the leftover hours “rolled over” for use in subsequent weeks. If the contracted 22.4 weekly flight hours were exceeded and no “rolled over” hours were available, Swift Air charged \$15,000 per additional hour. The maximum weekly flight hours were never exceeded.

³ The fee excluded aircraft reconfiguration costs and variable costs (e.g. fuel, baggage fees). Reconfiguration costs and variable costs are not at issue in the PAR, so they are not discussed in this PAR Response. See Fed. Election Comm’n, Preliminary Audit Report at 9 (Sept. 30, 2011) (“The General Committee correctly reimbursed the Primary Committee \$390,000 ... for these aircraft configuration costs.”).

⁴ See 11 C.F.R. § 9004.6.

⁵ 11 C.F.R. § 9004.6(a)(1).

⁶ Fed. Election Comm’n, Preliminary Audit Report at 10 (Sept. 30, 2011) (emphasis in original).

⁷ Fed. Election Comm’n, Preliminary Audit Report at 13 (Sept. 30, 2011).

⁸ Fed. Election Comm’n, Preliminary Audit Report at 13 (Sept. 30, 2011) (“The General Committee received reimbursements from the Press for campaign travel that were above the maximum amount billable to the Press. The Primary Committee appears to have billed an amount that was less than its cost.”).

General Committee used a reasonable process in the first instance to predict the eventual, proper allocation of Press reimbursements between the Committees; and (B) to the extent a misallocation of Press reimbursements between the two Committees still exists, it may correct the imbalance through a payment to the Primary Committee.

A. The Primary Committee and the General Committee Used a Reasonable Process to Predict the Eventual, Proper Allocation of Press Reimbursements between the General Committee and the Primary Committee

Commission rules require an authorized committee seeking reimbursement from Press entities to present an itemized invoice within 60 days of a campaign trip or event.⁹ The invoice must reasonably estimate a Press entity's pro rata share for the air transportation of "each segment of the trip," which is calculated by "dividing the total actual cost of the transportation and services provided by the total number of individuals to whom such transportation and services are made available."¹⁰

A travel segment's "total actual cost of the transportation" is comprised of both variable and fixed expenses. Variable expenses, such as fuel, catering, passenger taxes, and ground handling fees, are easily attributed to a particular travel segment since they are that same segment's direct costs. Fixed expenses are different. They are not the result of any particular travel segment and would exist even if a travel segment did not occur. To calculate the fixed-expense share of a travel segment's "total actual cost of the transportation," then, one must devise a method to assign some portion of the overall fixed cost to that single travel segment.

The Primary Committee and the General Committee presented itemized invoices that, as required, listed a reasonable estimate of each Press entity's pro rata share for air transportation, calculated by dividing the "total actual cost of the transportation" by the total number of individuals to whom the transportation was made available. Variable costs were easily attributed to each travel segment. To determine each travel segment's "total actual cost of the transportation," though, the two Committees still needed to devise a method to assign a portion of their fixed costs to each travel segment.

This was not easily done in advance with the two Committees' largest fixed transportation-related cost, the \$6,384,000 fee for 425.6 flight hours paid to Swift Air. (Again, this \$6,384,000 fee was a fixed expense, because it was still due in full even if fewer than the maximum 425.6 hours were ultimately flown.) The Committees knew the total fee (\$6,384,000), the total number of flight hours to which they were entitled (425.6 hours), and, therefore, the baseline hourly rate ($\$6,384,000 / 425.6 = \$15,000/\text{flight hour}$). But the final hourly rate for the

⁹ 11 C.F.R. § 9004.6(b)(3). See also 52 Fed. Reg. at 20886 (June 3, 1987) (stating that the rules permit an estimate of a media entity's costs because it "eases the burden of accounting precisely for such costs in the heat of the campaign. In addition, this allowance permits reimbursements received from some media organizations to compensate for those that do not pay in full.").

¹⁰ 11 C.F.R. § 9004.6(b)(2)-(3).

Swift Air contract could be calculated only at the end of the contract, when the Committees would know exactly how many flight hours over which to spread the \$6,384,000 fixed fee. While an hourly rate for a travel segment could be predicted, the ultimate hourly rate for that travel segment would fluctuate based on subsequent use or disuse of the plane. For example, the Press could be billed a pro rata share using a \$15,000 per-hour estimate for a July travel segment, but the ultimate hourly rate for that segment would go up if plane use was less than anticipated in August through November, or go down if the plane was flown more than expected in the post-July period. The Committees' calculations were therefore not hampered by "the fast pace of the election campaign," as the Audit Division surmised.¹¹ The Committees could not "calculate" here. At best, they could predict the proper hourly rate for a travel segment, knowing that the actual hourly rate would, in the end, depend on future, unknowable events.¹²

Facing this situation, the two Committees could have arbitrarily applied a calculation method or an hourly rate. Instead, the Committees undertook an effort to continually adjust each new travel segment's hourly costs based on the evolving total of estimated hours to be flown under the Swift Air contract.¹³ Press reimbursement billings were then sent out and collected using these estimated hourly costs. Realizing that the Swift Air contract straddled the primary- and general-election periods, the two Committees fully anticipated that they would need to later "rebalance" the Press reimbursements between them when the actual hourly rates for all travel segments became known (and knowable) after the 2008 election.

The Audit Division acknowledges that the Committees' method for predicting the proper allocation of Press reimbursements between the General Committee and the Primary Committee "reflect[s] the comparative actual use of the aircraft between the Primary ... and General Committees..."¹⁴ The Audit Division nonetheless advocates a new, never-before-announced technique for calculating a travel segment's hourly rate, and by extension, the proper allocation of Press reimbursements: divide each weekly installment of the \$6,384,000 Swift Air payment "divided by the actual weekly hours flown during the general election period..."¹⁵

The Audit Division's method is conveniently simple. But this simplicity is wrought by ignoring important realities about the Swift Air contract. For one, the Swift Air contract was jointly held by the Primary Committee and the General Committee. It spanned four months, straddling the divide between primary- and general-election periods. The Committees and Swift Air intended this exact structure. A four-month contract held by two entities is manifestly

¹¹ Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

¹² Because the actual hours flown were far less than the hours the Campaign was "entitled" by the contract (252.1 hrs v. 425.6 hrs), the actual per hour cost was much greater (\$25,208 per hour using the Campaign's methodology and \$27,350 per hour using the Audit Division's methodology) than the per hour cost envisioned by the contract (\$6,384,000 / 425.6 hours = \$15,000 per hour).

¹³ As the Audit Division noted, "The General Committee ... relied on adjusting the per hour billing rates on a segment-by-segment basis due to using fewer flight hours than available in the Swift Air contract. Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

¹⁴ Fed. Election Comm'n, Preliminary Audit Report at 13 (Sept. 30, 2011).

¹⁵ Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

different than a two-month contract held by one. The Audit Division, however, wants to now artificially bisect the Swift Air contract without even considering whether the parties would have structured two separate two-month contracts another way. For instance, the amount and frequency of the weekly installment payments might have been different, and the costs certainly would have been greater since a key factor in the cost of securing a dedicated aircraft is the lease's duration.¹⁶ The Audit Division cannot disregard a contract's fundamental elements without its analysis spinning into the realm of fiction.

The Audit Division also ignores that the Swift Air transaction was a fixed \$6,384,000 fee in exchange for up to 425.6 flight hours. The payment and the hours were divided into equal weekly installments, but a particular week's fixed installment payment was *not* in exchange for that week's flight hours. Dividing a week's installment payment by the week's actual flight hours therefore does not reflect what a travel segment's hourly rate and "total actual cost" were. Yet the Audit Division does that very thing, presumably to simplify the hourly rate calculations since one uses only a week's actual flight hours rather than waiting until the end of the contract to determine how many actual flight hours over which to spread the \$6,384,000 fixed fee.¹⁷ Simplicity is indeed attractive. It interferes with accurately calculating each travel segment's "total actual cost" here, though.

The Committees' calculation method for a travel segment's hourly rate, on the other hand, does not rely on counterfactuals. It recognizes the Swift Air contract as it is, and in doing so, is more consistent with Commission precedent and with Generally Accepted Accounting Principles. The Primary Committee and the General Committee therefore used a reasonable process to predict the eventual, proper allocation of Press reimbursements between the Committees.

1. The Committees' Calculation Method is More Consistent with Commission Precedent.

The Committees' calculation method to determine a travel segment's hourly rate was structured to match Commission precedent. That precedent is embodied in this instructive statement from the Dole-Kemp Final Audit Report, which discusses the proper method for prospectively estimating the hourly cost of a fixed-rate contract:

¹⁶ Regardless of whether the contract is for two months or four months, the aircraft operator/owner is required to place the aircraft through Federal Aviation Administration inspection and thereby remove the aircraft from regular commercial service. The cost of setup and servicing the aircraft for the inspection is relatively static. This allows the lessor of the aircraft to factor that cost throughout the duration of the contract adding to the weekly operating fee. Timing for the complex reconfiguration and then its return to an original state after use are also factors in determining the time the aircraft would be out of service for other commercial rentals. Therefore, the contract would naturally be cheaper based on the longer duration. Several outside experts on aircraft lease pricing confirmed this conclusion, that a four-month lease would be 5 percent to 20 percent less expensive than a four-month contract. The statements of those experts can be provided to the Commission up on request.

¹⁷ Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011) (stating that under the Audit Division's method "the actual flight hours are known soon after flights occur...")

The contracts for these aircraft contained a fixed price and specified the maximum number of hours that could be flown at that price. This required [Dole-Kemp] to estimate not only the variable costs (such as fuel, landing fees, catering, etc.) related to operating the aircraft, but also estimate the total number of hours to be flown by each aircraft. These estimates were revised several times during the campaign. The estimated hourly rate used by [Dole-Kemp] increased as the campaign progressed and then dropped slightly prior to the campaign's conclusion. The Audit staff determined the hourly rate for each aircraft by accumulating all operating costs and dividing that total by the actual number of hours flown by each aircraft. That calculation resulted in a significantly lower average hourly cost for the aircraft used by Senator Dole and Secretary Kemp than used by [Dole-Kemp] to bill the Press and Secret Service.¹⁸

The Dole-Kemp Audit staff's methodology for determining a travel segment's hourly rate for a fixed-rate contract was to divide the total amount of payments made under the aircraft lease by the total number of actual flight hours.

The Primary Committee and the General Committee assigned a portion of their \$6,384,000 fixed Swift Air payment to each travel segment using the methods employed by the Dole-Kemp Audit staff. They initially undertook an effort to continually adjust each new travel segment's hourly costs based on the evolving total of estimated hours to be flown under the Swift Air contract. Press reimbursement billings were then sent out and collected using these estimated hourly costs, realizing that the actual rate would differ from the estimate when the actual hourly rates for all travel segments became known (and knowable) after the 2008 election.

The Audit Division rejects the Committees' method because "only those costs attributable to the General Committee should be used in determining the travel cost the General Committee may bill to the Press"¹⁹ and because "the General Committee should recognize only those transportation costs from September 1, 2008 through November 4, 2008 in the calculation for billing the Press."²⁰ The Audit Division is only setting up "straw men" here so that it can knock them down. The Committees do not disagree with the Audit Division's truisms—certainly only Press reimbursements for general-election travel should be billed and kept by the General Committee. The real issues here are how should the Committees have predicted the amount of "those costs attributable to the General Committee"? And what was the proper method for prospectively calculating the "transportation costs from September 1, 2008 through November 4, 2008"? The Committees' point is that they used the Dole-Kemp method to calculate in advance each travel segment's hourly rate, and thereby used a reasonable method to predict the amount of Swift Air-related fixed "costs [that would be] attributable to the General Committee."

¹⁸ Fed. Election Comm'n, Final Audit Report on Dole for President Committee, et al. at 2 (2007) (emphasis added).

¹⁹ Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

²⁰ Fed. Election Comm'n, Preliminary Audit Report at 12 (Sept. 30, 2011).

The Audit Division also cites the Dole-Kemp Audit, but they tacitly suggest that the Dole-Kemp Audit prevents the Division from recognizing that the Swift Air contract extended back into the primary-election period. This is not the case. The Dole-Kemp Audit did indeed deal only with general-election activity, but that was because it was examining a general-election-only aircraft lease.²¹ The Dole-Kemp Audit's scope was limited by the underlying facts, not by any legal considerations. The Dole-Kemp Audit should therefore not be seen as precedent that the Audit Division may not recognize that the Swift Air contract extended back into the primary-election period.

Commission precedent is also valuable here. While only general-election committees are subject to mandatory audit,²² the Audit Division has conducted limited inquiries into primary-election committees concerning jointly held assets and other items. For example, the Kerry-Edwards 2004 and Bush-Cheney 2000 campaigns held air charter leases that, like the Swift Air contract, straddled the primary- and general-election periods.

The Kerry-Edwards 2004 Final Audit Report states that the campaign leased an aircraft for a period of seven months (April to November 2004).²³ This time frame clearly demonstrates a contract that crossed election periods and therefore is also potentially a reasonable comparison to the Committees' circumstance if the Audit records do indeed show a similar contract and payment structure. Additionally, the Kerry-Edwards 2004 air charter lease allowed unused flying hours to be "banked" each month and moved forward, as needed, without changing the overall cost of the contract. A total of 10.4 hours were banked from the Kerry-Edwards 2004 primary-election committee and used by their general-election committee instead. According to the post-election Final Audit Report, the general-election committee owed the primary-election committee a total of \$205,067 for these banked and transferred hours.²⁴ While not specifically stated in the Kerry-Edwards 2004 Final Audit Report, we believe that if unused "primary" banked hours were later used by their general-election committee and a reimbursement from the general committee to the primary committee was required after the fact to pay for those hours, there must also have been a misallocation of deposited offsets to those expenditures from the

²¹ Based on research of the news media from that time period and the Dole for President Committee reports filed with the Commission, it seems that the Dole Primary Committee had run out of room to spend money on normal operating expenses by May 1996, and therefore would not have had the opportunity, as our Campaign, Bush-Cheney 2000 and Kerry-Edwards 2004 did, to sign a contract for and implement reconfiguration costs related to a large air charter for a period of time that crosses the Primary/General periods. Research from the Commission reports shows that the Dole campaign's main air charter vendor was named "AV Atlantic." While we found millions of dollars in expenditures to that firm in September and October 1996, we could find no payments in June 1996 and only one payment to the firm in July 1996 during the end of the primary-election period. It would seem on its face, then, that the Dole Campaign's arrangement with its air charter vendor was vastly different than the type of contract setup the McCain Campaign used. We also note that a *New York Times* article during June 1996 validates the conclusion that the Dole Primary Committee did not have sufficient funds available to enter into the same type of agreement as our Campaign did. *New York Times*, "Democrats Charge Dole Violated Rules on Spending," 6/12/96 ("At the end of April, his campaign reported having spent all but \$177,000 of that sum...").

²² 11 C.F.R. § 9007.1(a).

²³ Fed. Election Comm'n, Final Audit Report on Kerry-Edwards 2004, et al. at 13 (2007).

²⁴ Fed. Election Comm'n, Final Audit Report on Kerry-Edwards 2004, et al. at 21 (2007).

Press by both committees. Press travel reimbursements could not have been properly reconciled by the Kerry-Edwards general committee if the Audit Division did not make them account for the 10.4 primary banked hours that were rolled forward to the general committee until after the audit was completed. Yet the Kerry-Edwards Final Audit Report does not include any comments or findings as to how Press reimbursements should be handled in these types of "cross-election" scenarios.

As for Bush-Cheney 2000, it held an aircraft lease with Miami Air International, Inc. that was structured in a manner nearly identical to the Swift Air contract.²⁵ The Miami Air International contract straddled the primary- and general-election periods, from August 1, 2000 to November 7, 2000, and entitled Bush-Cheney 2000 to a maximum number of flight hours for a fixed payment of \$3,444,312.88. The Bush-Cheney 2000 compliance staff used the same billing methodology for travel under this contract as the Committees did in 2008 with the Swift Air contract.²⁶ However, the Bush-Cheney 2000 Final Audit Report did not contain an adverse audit finding related to Press travel reimbursements. And the Audit Division did not even communicate informally any objection over calculation methodology to Bush-Cheney 2000 compliance staff, many of whom are now involved in the McCain Campaign audit. As the Audit Division put it:

The General Committee also referenced the 2000 Bush-Cheney audit and explained that it used the same billing methodology and personnel in that audit, which did not include an adverse audit finding or any informal advice from the Audit Division suggesting a correction to the accounting methods was necessary. The Audit Division acknowledges that the same billing methodology was used in 2000 Bush-Cheney...²⁷

The Division excuses its silence during the Bush-Cheney 2000 audit now by claiming that "the amount of the overbilling of the Press was not material."²⁸ This statement is highly questionable. Press reimbursements were not minimal—over \$40,000 was sought under the Miami Air International contract during the primary election and the Bush-Cheney campaign incurred over \$200,000 in travel expenses during that same period.²⁹ Putting aside the amount, though, the Audit Division still should have given notice of methodology errors, even if the Division now somehow considers the amount involved as "not material." In the context of an audit, the Commission's acquiescence in a recordkeeping practice has precedential value because silence is reasonably construed by the audited party as approval. This is particularly the case where, as here, the Commission has otherwise failed to issue general guidance concerning a particular

²⁵ Bush-Cheney 2000 Contract with Miami Air International, Inc. attached hereto as Attachment A.

²⁶ Bush-Cheney 2000 Press Reimbursement Spreadsheet attached hereto as Attachment B.

²⁷ Fed. Election Comm'n, Preliminary Audit Report at 11 (Sept. 30, 2011).

²⁸ Fed. Election Comm'n, Preliminary Audit Report at 11 (Sept. 30, 2011).

²⁹ Bush-Cheney 2000 Press Reimbursement Spreadsheet attached hereto as Attachment B.

recordkeeping practice. Indeed, “if an agency glosses over or swerves from prior precedents without discussion it may cross the line from the tolerably terse to the intolerably mute.”³⁰

The Audit Division should not be allowed to “swerve” from prior precedent here. The Primary Committee and the General Committee followed the Commission-audited campaigns’ proven path. Particularly, the Bush-Cheney 2000 method for a fixed-rate contract that straddled primary- and general-election periods was replicated exactly because, again, the same compliance consultants and personnel were involved in the two campaigns. The calculation method used by the Primary Committee and the General Committee is clearly more consistent with Commission precedent than the Audit Division’s favored method. The two Committees therefore used a reasonable process to predict the eventual, proper allocation of Press reimbursements between the Committees.

2. The Committees’ Calculation Method Is More Consistent with Generally Accepted Accounting Principles

The Committees’ calculation method is based on rules and standards adopted by the accounting profession called Generally Accepted Accounting Principles (“GAAP”) that are used to prepare, present, and report financial statements.³¹ The Commission has endorsed GAAP’s use in presidential campaign audits and cited GAAP to make an adverse audit finding against the Kerry-Edwards Campaign.³¹

GAAP dictates the use of accrual-basis accounting in nearly all circumstances.³³ In accrual-basis accounting, revenue is recognized when it is earned and expenses are recognized when incurred. This is in contrast to cash-basis accounting, a non-GAAP method, which records revenue when cash is received and an expense when cash is paid.³⁴ Why is accrual-basis accounting a GAAP method and cash-basis accounting not? Because “[i]n many instances, the cash basis just does not present fully enough the financial picture...”³⁵ After all, the timing of cash receipts and payments may be detached from a transaction’s underlying substance.

³⁰ *Bush-Quayle '92 Primary Comm., Inc. v. Fed. Election Comm'n*, 104 F.3d 448, 453 (D.C. Cir. 1997) (citing *Greater Boston Tel. Corp. v. FCC*, 444 F.2d 841, 852 (D.C.Cir.).

³¹ BARRY J. EPSTEIN, RALPH NACH & STEVEN M. BRAGG, WILEY GAAP: 2010 INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES 2-4 (2010).

³² Fed. Election Comm’n, Final Audit Report on Kerry-Edwards 2004, et al. at 13-14 (2007).

³³ RICHARD F. LARKIN & MARIE DiTOMMASO, WILEY 2011 NOT-FOR-PROFIT GAAP: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR NOT-FOR-PROFIT ORGANIZATIONS 9, 17 (2011) (“For financial reporting in accordance with generally accepted accounting principles, the accrual basis of accounting must be used.”).

³⁴ DONALD E. KIRSO, JERRY J. WEYGANDT & JERRY D. WARFIELD, INTERMEDIATE ACCOUNTING: PROBLEM SOLVING SURVIVAL GUIDE 3-4 (2011).

³⁵ RICHARD F. LARKIN & MARIE DiTOMMASO, WILEY 2011 NOT-FOR-PROFIT GAAP: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR NOT-FOR-PROFIT ORGANIZATIONS 14 (2011).

The Primary Committee and the General Committee used GAAP-compliant accrual-basis accounting to calculate the fixed-expense share of each travel segment's "total actual cost of the transportation." Accrual-basis accounting required that the Swift Air contract expenses (and offsets to those expenses in the form of Press reimbursements) were recognized as actual flight hours were used. A portion of the Swift Air contract's fixed cost was assigned to each travel segment using a depreciation technique called the "units of production" method, which is expressed as $\text{Cost} / \text{Estimated Units} = \text{Depreciation Per Unit Produced}$ (i.e. $\$6,384,000 / \text{Estimated Flight Hours} = \text{Aircraft Hourly Rate}$).³⁶ The "units of production" method was most appropriate here because the actual flight hours, and thus the actual contract costs, were not incurred ratably over the individual weeks of the contract.³⁷

By contrast, the Audit Division relied on non-GAAP cash-basis accounting to estimate the fixed-expense share of each travel segment's "total actual cost of the transportation." The "Audit staff used the weekly \$336,000 installment" as the trigger for recording expenses (and offsets to those expenses in the form of Press reimbursements).³⁸ Like all cash-basis accounting, this simplifies the hourly rate calculations since one uses only a week's actual flight hours rather than waiting until the end of the contract to determine how many actual flight hours over which to spread the \$6,384,000 fixed fee. But again, like all cash-basis accounting, this does not offer a fully accurate picture of the transaction here because a week's installment payment was *not* paid to Swift Air in exchange for that week's installment of flight hours.

When the PAR reaches this subject, the Audit Division declares, all too conveniently, that "cash or accrual-basis accounting" is not "[t]he issue."³⁹ GAAP-compliant methods, in the Audit Division's view, are "[t]he issue" only when candidates fail to use them.⁴⁰ The Audit Division then artfully changes the subject rather than confess that it used non-GAAP accounting:

At issue is whether the activity of a separate reporting and corporate entity (the Primary Committee) should be recognized by the General Committee and by this audit. An underlying assumption to GAAP is that every entity is separate and, therefore, the revenue and expenses of each entity should be recognized as such.⁴¹

³⁶ Depreciation is not a matter of valuation, but a means of cost allocation. The method of depreciation chosen must result in the systematic and rational allocation of the cost of the asset (less its residual value) over the asset's expected useful life. See RICHARD F. LARKIN & MARIE DiTOMMASO, WILEY 2011 NOT-FOR-PROFIT GAAP: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR NOT-FOR-PROFIT ORGANIZATIONS 239 (2011).

³⁷ RICHARD F. LARKIN & MARIE DiTOMMASO, WILEY 2011 NOT-FOR-PROFIT GAAP: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR NOT-FOR-PROFIT ORGANIZATIONS 240 (2011).

³⁸ Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

³⁹ Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

⁴⁰ See Fed. Election Comm'n, Final Audit Report on Kerry-Edwards 2004, et al. at 13-14 (2007).

⁴¹ Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

Again, this “corporate separateness” statement does not validate the Audit Division’s reliance on cash-basis accounting—just because one treats corporations as separate entities does not mean one should arbitrarily use weekly installment payments as the basis for calculating a travel segment’s “total actual cost.”

The Audit Division’s point about corporate separateness instead seems to be that the Division must bisect the Swift Air contract and entirely disregard its primary-election portion.⁴² This is, again, counterfactual. The Primary Committee and the General Committee are separate for Commission reporting purposes and only the General Committee is subject to mandatory audit, but they are otherwise tightly integrated entities, having shared a candidate, staff members, consultants, the Swift Air contract, and other resources.⁴³ The Audit Division suggests GAAP mandates its proposed suspension of reality, but that suggestion is incorrect. In fact, GAAP provides for separate commonly controlled organizations that share an economic interest, like the Primary Committee and the General Committee, to issue consolidated financial figures.⁴⁴ And GAAP’s “matching principle” counsels against bisecting the Swift Air contract, as it requires the cost of a long-lived asset to be allocated over all of the accounting periods during which the asset is used (i.e. the entire contract period).⁴⁵

In sum, the calculation method used by the Primary Committee and the General Committee is more consistent with GAAP. The two Committees therefore used a reasonable process to predict the eventual, proper allocation of Press reimbursements between the Committees.

B. To the Extent a Misallocation of Press Reimbursements between the Committees Still Exists, the General Committee May Correct the Imbalance through a Payment to the Primary Committee

⁴² Interestingly, in the Kerry-Edwards Final Audit Report, the Audit Division quotes the Wiley GAAP 2007 Interpretation and Application of Generally Accepted Accounting Principles textbook stating, “costs that are capitalized upon acquisition are any reasonable cost involved in bringing the asset to the buyer and incurred prior to using the asset.” The reason the Audit Division includes this section is to later make its point that part of the reconfiguration costs paid by the Primary Committee are really owed by the General Committee. The Campaign finds this passage interesting because the Audit Division has shown that it is ok to bridge Committees and they use the principles of GAAP when making their findings that the reconfiguration costs for travel purposes are a capital asset that must be calculated and paid for by the General Committee even though the checks were originally written during the Primary Committee. Having interpreted GAAP previously as requiring a “cross-election” inquiry earlier, it is not apparent how the Audit Division may now make the opposite claim. Fed. Election Comm’n, Final Audit Report on Kerry-Edwards 2004, et al. at 13-19 (2007).

⁴³ 11 C.F.R. § 9007.1(a).

⁴⁴ RICHARD F. LARKIN & MARIE DiTOMMASO, WILEY 2011 NOT-FOR-PROFIT GAAP: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR NOT-FOR-PROFIT ORGANIZATIONS 160 (2011).

⁴⁵ See PATRICK R. DELANEY, RALPH NACH, BARRY J. EPSTEIN & SUSAN W. BUDAK, WILEY GAAP 2003: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES 66 (2003).

The General Committee believes that, to the extent a misallocation of Press reimbursements between the General Committee and the Primary Committee still exists, the General Committee may correct the imbalance through a payment to the Primary Committee. The Audit Division contends that this is impossible, as “refunding the Primary Committee ... would be considered a non-qualified campaign expense subject to repayment.”⁴⁶ The Audit Division is wrong for several reasons.

First, the Audit Division cites the “qualified campaign expense” definition for the proposition that “regulation state that a general election committee cannot incur primary-related expenses because they are not in furtherance of the general election.”⁴⁷ This is a misstatement of the law. Primary-election expenses do indeed fall outside the “qualified campaign expense” definition. But not all funds received by a general-election candidate committee must be spent only for a “qualified campaign expense.” Commission rules are precise: “An eligible candidate shall use payments received under 11 CFR part 9005 only ... [t]o defray qualified campaign expenses...”⁴⁸ Funds received under circumstances outside Part 9005 (concerning the general-election public grant), such as Press reimbursements, are not similarly restricted.

Second, the Audit Division never explains how the General Committee’s transfer to the Primary Committee would be an “expense” at all—qualified or non-qualified. The General Committee and the Primary Committee are “affiliated.”⁴⁹ For contribution limit purposes, affiliated committees are “considered ... a single political committee” and transfers between them are unlimited by typical restraints on movement of funds.⁵⁰ The General-to-Primary transfer itself would therefore not be an “expense.” Now, the Audit Division may counter that the “expense” refers to the Primary Committee’s outlay for Press travel. This is also incorrect. The Primary Committee, according to the Audit Division, already paid for Press travel without recouping its full costs.⁵¹ Given that it is over three years after the 2008 election, funds transferred to the Primary Committee will likely sit in the Primary Committee’s bank account without actually defraying *any* primary-election activity. In other words, the General Committee will not actually incur any primary-related expenses. The transfer is simply to correct what the Audit Division views as the original “misdeposit” of Press reimbursements.

Third, the transfer would not be a “non-qualified expense” because the Commission has in the past repeatedly permitted transfers from publicly funded general-election committees to their affiliated primary-election committees to correct misallocation and similar issues. For example, the Commission required the Kerry-Edwards Campaign’s general-election committee to pay the Campaign’s primary-election committee to fix a misallocation of joint reconfiguration

⁴⁶ Fed. Election Comm’n, Preliminary Audit Report at 13 (Sept. 30, 2011).

⁴⁷ Fed. Election Comm’n, Preliminary Audit Report at 13 (Sept. 30, 2011).

⁴⁸ 11 C.F.R. § 9004.4(a)(1).

⁴⁹ 11 C.F.R. § 100.5(g).

⁵⁰ 11 C.F.R. § 110.3(a)(1), (c).

⁵¹ Fed. Election Comm’n, Preliminary Audit Report at 13 (Sept. 30, 2011) (“The Primary Committee appears to have billed an amount that was less than its cost.”)

costs and banked flight hours.⁵² Here, the circumstances are similar. The General Committee is, according to the Audit Division, receiving another "free ride" at the Primary Committee's expense. The Primary Committee's Press cost-to-reimbursement balance is negative, while the General Committee's is positive. The General Committee should be allowed to transfer funds to reach a cost-benefit equilibrium for both Committees.

And finally, a General-to-Primary transfer should not be prevented under the Audit Division's "non-qualified expense" rationale because the only reason for this misallocation issue is the Commission's failure to provide guidance on how to prospectively calculate the fixed-cost portion of a particular travel segment's "total actual cost of ... transportation." The Primary Committee and the General Committee had no notice that they were not using the Commission's preferred calculation method. In fact, the Commission's past acquiescence during the 2000 election cycle led directly to the Primary Committee and the General Committee using the cost calculation method that they did, adjusting each new travel segment's hourly costs based on the evolving total of estimated hours to be flown under the Swift Air contract. This was a reasonable method in light of the Commission's silence and misleading acquiescence, and the General Committee should not be penalized through a forced refund to Press entities. The Commission should permit the transfer here, even if it decides not to do so for future committees, who now understand the Commission's preferred calculation method under these circumstances.

In sum, the General Committee asserts that to the extent a misallocation of Press reimbursements between the General Committee and the Primary Committee still exists, the General Committee may correct the imbalance through a payment to the Primary Committee. The Audit Division claims this is legally prohibited because the transfer would be a "non-qualified campaign expense." The Audit Division's claim is undermined, however, by the text of Commission rules, the "affiliated" status of the General and Primary Committees, the Commission's practice of allowing transfers to correct misallocation-like issues, and the Commission's failure to provide advance guidance on Press reimbursement calculations. We respectfully request that the Commission permit the transfer from the General Committee to the Primary Committee to resolve any lingering misallocation of Press reimbursements between them. In the event the Commission somehow does not permit the transfer, the General Committee asks that it be allowed to disgorge the Press reimbursements to the U.S. Treasury, as has been permitted previously.⁵³

⁵² Fed. Election Comm'n, Final Audit Report on Kerry-Edwards 2004, et al. at 19-22 (2007).

⁵³ Fed. Election Comm'n, Final Audit Report on the Mondale-Ferraro Committee at 23 (1987) ("The Interim Audit Report included an amount for accounts payable due the Press of \$32,381.36 which represented amounts collected from the Press for air charters and incidentals which were in excess of amounts billed. The figure was as of March 31, 1985. The General Fund's response, verified by follow-up fieldwork, indicates that after March 31, 1985 an additional \$927.40 was received. Therefore, accounts payable due the Press has been increased to \$33,308.76. General Fund officials intend to research these prior to making any refunds. A review of the General Fund's disclosure reports through September 30, 1986 show that none of these refunds have been made. *If it is determined that the refunds will not be made, the amount of the surplus repayment [to the US Treasury assumed to be also for other items and their receipt of the federal grant] should be adjusted accordingly.*") (emphasis added).

II. 48-HOUR NOTICES

The Audit Division has identified some contributions included on the Compliance Fund's December 4, 2008 Post-General Report that did not appear on "48-Hour Notices" filed before the election.

Under Commission regulations, authorized committees must file a notice within 48 hours "if any contribution of \$1,000 or more is received . . . after the 20th day, but more than 48 hours" before 12:01 a.m. on Election Day (October 16th to November 1st during the 2008 election cycle).⁵⁴ The Compliance Fund filed 48-hour notices on October 17th, 22nd, 24th, 29th, and 31st.

The Compliance Fund previously addressed this matter in its Exit Conference Response and in a March 5, 2009 letter to the Reports Analysis Division. The Compliance Fund has explained that 48-Hour Notices were not required for many contributions identified by the Commission throughout the audit process, as they were merely redesignations that took place during the 48-Hour Notice reporting period⁵⁵ or they were refunded immediately after receipt.⁵⁶ And as noted in the March 5th letter, the Compliance Fund's normal practice of filing a 48-Hour Notice was not followed for a remaining group of contributions, due to data-management errors made by its outside vendor. To elaborate, the Compliance Fund's outside data-management vendor "tagged" this group of contributions with an incorrect date in its database and consequently failed to locate the group in a subsequent, computerized search for contributions requiring a 48-Hour Notice. The Compliance Fund has now taken measures with this outside vendor to ensure that this unintentional oversight is corrected, and Compliance Fund staff believes that this was a one-time occurrence. And, as stated above, Compliance Fund subsequently and fully disclosed all of these contributions in its Post-General 2008 Report.

48-Hour Notices are intended to bring to light any last-minute contributions that a candidate might deploy for campaign-related activities, such as advertising and get-out-the-vote efforts, during an election's final days. Donations to the Compliance Fund, however, may not be used for any candidate's election and may only support "legal and accounting services to ensure

⁵⁴ 11 C.F.R. § 104.5(f).

⁵⁵ The Eileen Kamerick contribution (received by JM2008 2008 10/23/2008; redesignated 10/23/2008) identified by the Audit Division on its PAR list was redesignated during the 48-Hour Notice Period. The Compliance Fund did not receive any of these contributions during the Notice period. This contribution was originally received by John McCain 2008, the primary-election committee, and was merely redesignated by the contributor during the Notice period. The redesignation itself did not cause the Compliance Fund to receive any funds, and this contribution was received by the Compliance Fund only after the Notice period ended. The date listed under "Date of Receipt" on the Compliance Fund's Post-General 2008 Report was intended only to identify the date on which the contributor authorized redesignation. The Compliance Fund therefore did not list, and did not need to list, this redesignation on any 48-Hour Notice.

⁵⁶ Jeffrey A. Hill's entire \$1000 donation was refunded on Nov. 2, 2008; \$200 of Cole Farsyth's \$2,500 contribution was refunded on Nov. 2, 2008; \$200 of Thomas Meehan's \$2,500 contribution was refunded on Nov. 2, 2008; and \$2,700 of Stuart Harris's \$5,000 contribution was refunded on Nov. 10, 2008. It is our view that no fine should be levied on the portions of these transactions that were refunded as the Compliance Fund was not able to keep the receipts in its bank accounts or spend them on any election-related activities.

compliance with Federal law.”⁵⁷ It should also be noted that the Compliance Fund today maintains a balance of over \$10 million, meaning that these funds received shortly before the 2008 general election still have not been spent for any purpose. The Compliance Fund was therefore not in material violation of the 48-hour notice requirement when its reliance on an outside vendor caused it to delay disclosure of donations that would only fund lawyers’ and accountants’ legal compliance activities. For these same reasons, the Compliance Fund should not be fined for this vendor failure even if the Commission somehow finds that a technical infringement of the 48-hour notice requirement occurred.

Finally, the Compliance Fund requests that the Commission provide in the Final Audit Report a description of how the 48-Hour Notice will be resolved (e.g. no action, enforcement matter, administrative fine program), as this decision will impact the Compliance Fund’s ability to terminate. The Compliance Fund would like to terminate as soon as possible so that it does not incur needless wind-down expenses.

III. CONCLUSION

For all of the foregoing reasons, McCain-Palin 2008 and McCain-Palin Compliance Fund believe the Final Audit Report should state that the Commission found no legal violations and that the two committees may terminate their registrations with the Commission immediately.

Respectfully Submitted,

(signed)

Salvatore A. Furpura

Assistant Treasurer

McCain-Palin 2008 and McCain-Palin Compliance Fund

⁵⁷ 11 C.F.R. § 9003.3(a)(1)(i)(A).